

AUDITING PROCEDURES REPORT

Issued under P.A. 2 of 1968, as amended. Filing is mandatory.

Local Government Type: <input type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Government Name: <u>City of Pontiac Police and Fire Retirement System</u>	County <u>Oakland</u>
Audit Date December 31, 2004	Opinion Date April 29, 2005	Date Accountant Report Submitted To State: June 30, 2005	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations.

You must check the applicable box for each item below:

- | | |
|---|---|
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements. |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act. |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91] or P.A. 55 of 1982, as amended [MCL 38.1132]) |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit. |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95). |

We have enclosed the following:	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Reports on individual federal assistance programs (program audits).	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Single Audit Reports (ASLGU).	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>

Certified Public Accountant (Firm Name): PLANTE & MORAN, PLLC			
Street Address 27400 Northwestern Highway	City Southfield	State MI	ZIP 48037
Accountant Signature <i>Plante & Moran, PLLC</i>			

City of Pontiac
Police and Fire Retirement System

Financial Report
with Required Supplemental Information
December 31, 2004

City of Pontiac

Police and Fire Retirement System

Contents

Report Letter	I
Management's Discussion and Analysis	2-3
Basic Financial Statements	
Statement of Plan Net Assets	4
Statement of Changes in Plan Net Assets	5
Notes to Financial Statements	6-9
Required Supplemental Information	10
Schedule of Analysis of Funding Progress	11
Schedule of Employer Contributions	12

Independent Auditor's Report

To the Retirement Board
City of Pontiac Police and Fire
Retirement System

We have audited the accompanying statement of plan net assets of the City of Pontiac Police and Fire Retirement System (a component unit of the City of Pontiac, Michigan) as of December 31, 2004 and the related statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of the Police and Fire Retirement Board of the City of Pontiac. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the City of Pontiac Police and Fire Retirement System as of December 31, 2004 and the results of its operations for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis and required supplemental information (identified in the table of contents) are not a required part of the basic financial statements but are supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

Plante & Moran, PLLC

April 29, 2005

City of Pontiac

Police and Fire Retirement System

Management's Discussion and Analysis

Using this Annual Report

This annual report consists of three parts: (1) management's discussion and analysis (this section), (2) the basic financial statements, and (3) required supplemental information. The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data. The statements are followed by a section of required supplemental information that further explains and supports the information in the financial statements.

Condensed Financial Information

The table below compares key financial information in a condensed format between the current year and the prior year:

	Fiscal Year Ended December 31	
	2004	2003
Total assets	\$ 266,169,012	\$ 266,824,107
Liabilities:		
Amounts due to broker under securities lending agreement	19,362,887	26,785,584
Other liabilities	214,038	257,167
Total liabilities	19,576,925	27,042,751
Assets held in trust for pension benefits	\$ 246,592,087	\$ 239,781,356
Net investment income	\$ 16,550,195	\$ 33,934,402
Net securities lending income	24,579	29,238
Contributions:		
Employee - Reinstated members	392,791	382,794
Employer	2,141,247	2,008,947
Benefits paid to members and retirees:		
Retiree pension and annuity benefits	12,114,123	11,815,325
Member refunds and withdrawals	47,626	100,589
Total benefits paid	12,161,749	11,915,914
Benefits paid in excess of contributions	9,627,711	9,524,173
Ratio of benefits paid to contributions	479.9%	498.0%
General and administrative expenses	136,332	183,605
Net increase in net assets held in trust	\$ 6,810,731	\$ 24,255,862

City of Pontiac

Police and Fire Retirement System

Management's Discussion and Analysis (Continued)

Overall Fund Structure and Objectives

The Police and Fire Retirement System (the "Retirement System") exists to pay benefits to its members and retirees. Active members earn service credit that entitles them to receive benefits in the future. Benefits currently being paid are significantly greater than contributions currently being received. The excess of benefits over contributions must be funded through investment income. The public capital markets represent the primary source of investments.

Asset Allocation

The Retirement System has established asset allocation policies, which are expected to deliver more than enough investment income over a very long period of time to satisfy the obligations to pay the benefits promised to the members of the Retirement System. The following is a summary of the asset allocation as of December 31, 2004:

Domestic equities	41%
International equities	14%
Domestic fixed income	37%
Real estate	8%

Investment Results

In 2004, U.S. equities were helped by strong profits, low inflation, and low interest rates. U.S. bonds were helped by moderate employment gains and tightening monetary policy which increased investors' optimism regarding inflation and allowed long-term rates to fall during the last quarter of the year. The domestic equity market, as measured by the S&P 500 index, returned 10.9 percent for the year. The fixed income market, as measured by the Lehman Aggregate index, returned 4.3 percent for the year. The total fund returned 10.1 percent for the year.

The Retirement System's total fund return must always be considered in a longer-term context. The asset allocation of each fund is built upon the foundation that the obligations of the Retirement System to pay the benefits promised to members and retirees are very long-term obligations. Accordingly, the board of trustees must make investment decisions that it believes will be the most beneficial to the Retirement System over many years, not just one or two years.

City of Pontiac

Police and Fire Retirement System

Statement of Plan Net Assets December 31, 2004

Assets

Cash (Note 3)	\$ 103,869
Cash and investments held as collateral for securities lending (Note 3)	19,362,887
Accounts receivable:	
Due from City of Pontiac	193,204
Due from City of Pontiac General Employees' Retirement System	2,889
Due from City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust	36,500
Other	<u>1,168</u>
Total accounts receivable	233,761
Accrued interest and dividends receivable	388,620
Investments at fair value - Including loaned securities (Note 3):	
Money market and mutual funds	7,051,160
U.S. government obligations	7,790,148
Corporate and other bonds	42,726,744
Equities	158,426,448
U.S. government agency mortgage pools	12,561,479
Interest in CAP Commercial Mortgage, LLC	5,190,487
Real estate - CAPROC, LLC	<u>12,333,409</u>
Total investments	<u>246,079,875</u>
Total assets	266,169,012

Liabilities

Accounts payable	207,740
Due to broker for pending transactions	6,298
Amounts due broker under securities lending agreement (Note 3)	<u>19,362,887</u>
Total liabilities	<u>19,576,925</u>

Net Assets Held in Trust for Pension Benefits (a schedule of
funding progress is presented in the additional information)

\$ 246,592,087

City of Pontiac

Police and Fire Retirement System

Statement of Changes in Plan Net Assets Year Ended December 31, 2004

Additions

Investment income (loss):	
Interest and dividend income	\$ 5,132,127
Net appreciation in fair value	12,542,986
Investment advisor fees	(1,200,064)
Litigation settlement	<u>75,146</u>
Net investment gain	16,550,195
Securities lending income (loss):	
Interest and fees	256,567
Less borrower rebates and bank fees	<u>(231,988)</u>
Net securities lending income	24,579
Contributions:	
Employee	392,791
Employer	<u>2,141,247</u>
Total additions	19,108,812

Deductions

Retirees' pension benefits and retirement incentives	12,114,123
Member refunds and withdrawals	47,626
Other expenses	73,172
Charges from the City - Administrative expenses	<u>63,160</u>
Total deductions	<u>12,298,081</u>

Net Increase in Net Assets Held in Trust for Pension Benefits 6,810,731

Net Assets Held in Trust for Pension Benefits - January 1, 2004 239,781,356

Net Assets Held in Trust for Pension Benefits - December 31, 2004 \$ 246,592,087

City of Pontiac

Police and Fire Retirement System

Notes to Financial Statements
December 31, 2004

Note 1 - Summary of Significant Accounting Policies

The City of Pontiac (the "City") sponsors and administers the Police and Fire Retirement System (the "Retirement System") (a contributory single-employer retirement plan) that covers all police and fire employees of the City.

Reporting Entity - The financial statements of the Retirement System are also included in the combined financial statements of the City of Pontiac as a pension trust fund. The assets of the pension trust fund include no securities of or loans to the City or any other related party.

Basis of Accounting - The Retirement System's financial statements are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

Methods Used to Value Investments - Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Mortgages are valued on the basis of future principal and interest payments and are discounted at prevailing interest rates for similar instruments. The fair value of real estate investments is based on independent appraisals or audited financial statements.

Note 2 - Plan Description and Contribution Information

At December 31, 2003, the date of the most recent actuarial valuation, membership consisted of the following:

Retirees and beneficiaries currently receiving pension benefits and terminated employees entitled to benefits but not yet receiving them	<u>352</u>
Current employees:	
Fully vested	139
Nonvested	<u>148</u>
Total current employees	<u>287</u>

City of Pontiac

Police and Fire Retirement System

Notes to Financial Statements
December 31, 2004

Note 2 - Plan Description and Contribution Information (Continued)

Plan Description - The Retirement System provides retirement benefits, as well as death and disability benefits. Employees may receive cost of living adjustments as a percentage of their base amount, pursuant to the collective bargaining agreement in effect at their date of retirement. The obligation to contribute to and maintain the Retirement System was established by City ordinance and negotiation with the employees' collective bargaining units.

Contributions - Plan members are required to contribute 2.5 percent of their annual salaries. The City is required to contribute at an actuarially determined rate. Administrative costs are financed through investment earnings.

Note 3 - Deposits and Investments

Deposits - At year end, total bank deposits were comprised of \$103,869 without recognition of deposits in transit or outstanding checks, of which \$100,000 was covered by federal depository insurance.

Investments - The Retirement System is authorized by Michigan Public Acts to invest in U.S. bonds and notes, certain commercial paper, U.S. government repurchase agreements, bankers' acceptances and mutual funds, investment pools that are composed of authorized investment vehicles, certain reverse repurchase agreements, stocks, diversified investment companies, annuity investment contracts, real estate leased to public entities, mortgages, debt or equity of certain small businesses, certain state and local government obligations, and certain other specified investment vehicles.

All of the Retirement System's investment securities, other than \$18,839,118 of securities lent to broker-dealers, \$7,051,160 of money market and mutual funds, and \$12,333,409 invested in CAPROC, are either insured, registered, or held by the Retirement System or its agents in the Retirement System's name. Securities held by broker-dealers are not categorized by investment risk category. Mutual funds are not categorized because they are not evidenced by securities that exist in physical or book entry form. The fair value of the mutual funds is the same value as the pool shares. The investment in CAPROC is uninsured and unregistered, with securities held in the Retirement System's name. Management believes that the investments of the Retirement System comply with the investment authority noted above.

The investment in CAPROC, totaling approximately \$12,333,000, represents more than 5 percent of the Retirement System's net assets. Two of the 12 members on the CAPROC board are police and fire trustees.

City of Pontiac

Police and Fire Retirement System

Notes to Financial Statements
December 31, 2004

Note 3 - Deposits and Investments (Continued)

Included in the Retirement System's investments at December 31, 2004 are the following:

- Approximately \$6,375,000 of securities issued by the Government National Mortgage Association (GNMA). These investments are backed by the full faith and credit of the U.S. government. The yields provided by these mortgage-related securities historically have exceeded the yields on other types of U.S. government securities with comparable maturities, in large measure due to the potential for prepayment. Prepayment could result in difficulty in reinvesting the prepaid amounts in investments with comparable yields.
- Approximately \$6,186,000 of obligations of the Federal National Mortgage Association and Federal Home Loan Mortgage Corporation. These investments are usually not backed by the full faith and credit of the U.S. government, but are generally considered to offer modest credit risks. The yields provided by these mortgage-related securities historically have exceeded the yields on other types of U.S. government securities with comparable maturities, in large measure due to the potential for prepayment. Prepayment could result in difficulty in reinvesting the prepaid amounts in investments with comparable yields.

As permitted by state statutes, and under the provisions of a Securities Lending Authorization Agreement, the Retirement System lends securities to broker-dealers and banks for collateral that will be returned for the same securities in the future. The Retirement System's custodial bank manages the securities lending program and receives cash as collateral. Borrowers are required to deliver collateral for each loan equal to not less than 100 percent of the market value of the loaned securities. During the year ended December 31, 2004, only United States currency was received as collateral.

The Retirement System did not impose any restrictions during the fiscal year on the amount of loans made on its behalf by the custodial bank. There were no failures by any borrowers to return loaned securities or pay distributions thereon during the fiscal year. Moreover, there were no losses during the fiscal year resulting from a default of the borrowers or custodial bank.

City of Pontiac

Police and Fire Retirement System

Notes to Financial Statements
December 31, 2004

Note 3 - Deposits and Investments (Continued)

The Retirement System and the borrower maintain the right to terminate all securities-lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other lenders, in an investment pool. The average duration of such investment pool as of December 31, 2004 was 32 days. Because the loans are terminable on demand, their duration did not generally match the duration of the investments made with cash collateral. On December 31, 2004, the Retirement System had no credit risk exposure to borrowers. The collateral held and the fair market value of underlying securities on loan for the Retirement System as of December 31, 2004 were \$19,362,887 and \$18,839,118 respectively.

Note 4 - Reserves

State law requires employee contributions to be segregated. In addition, amounts must be set aside as determined by the actuary to fund benefits to retirees currently approved to receive benefits. As of December 31, 2004, the Retirement System's reserves have been fully funded as follows:

Reserved for employee contributions	\$ 3,267,313
Reserved for retired employees	137,001,492

Required Supplemental Information

City of Pontiac

Police and Fire Retirement System

Required Supplemental Information Schedule of Analysis of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll
12/31/98	\$ 199,564,679	\$ 173,110,779	\$ (26,453,900)	115.3	\$ 12,176,366	-
12/31/99	221,634,281	181,139,103	(40,495,178)	122.4	12,851,614	-
12/31/00	239,667,248	191,594,863	(48,072,385)	125.1	13,462,955	-
12/31/01	245,966,812	203,166,600	(42,800,212)	121.1	13,710,467	-
12/31/02	239,657,864	204,588,488	(35,069,376)	117.1	13,528,501	-
12/31/03*	234,029,363	215,949,176	(18,080,187)	108.4	15,308,134	-

* Plan amended

City of Pontiac

Police and Fire Retirement System

Required Supplemental Information Schedule of Employer Contributions

Year Ended December 31	Annual Required Contribution	Percentage Contributed
1999	\$ 3,072,341	116.90
2000	2,231,028	106.70
2001	2,168,043	100.00
2002	1,809,736	100.00
2003	2,008,947	100.00
2004	2,141,247	100.00

The information presented above was determined as part of the actuarial valuations at the dates indicated. Additional information as of December 31, 2003, the latest actuarial valuation, follows:

Actuarial cost method	Individual entry age normal cost
Amortization method	Level percent of payroll, closed periods
Remaining amortization period	21 - 34 years
Asset valuation method	Market value with four-year smoothing of changes in security prices
Actuarial assumptions:	
Investment rate of return*	7.5%
Projected salary increases*	5.5% to 14.1%
*Includes inflation at	4.5%
Cost of living adjustments	2%

April 29, 2005

Mr. Eugene White, Chairman (GERS)
Mr. Craig Storum, Chairman (PFRS)
Mr. Ed Hannan, Chairman (General VEBA)
Mr. Brian Lee, Chairman (Police and Fire VEBA)
City of Pontiac Retirement Boards
General Employees Retirement System
Police and Fire Retirement System
47450 Woodward Ave
Pontiac, MI 48342

Dear Mr. White, Mr. Storum, Mr. Hannan and Mr. Lee:

We recently completed the audits of the General Employees Retirement System and the Police and Fire Retirement System (the Systems), as well as the related VEBAs, for the year ended December 31, 2004. We continue to be impressed with the organized and thorough manner in which Deborah Munson prepared for the audit. Her assistance in preparing the necessary schedules was greatly appreciated. As a result of the audit, we offer the following comments and recommendations for your consideration:

Retiree Health Care Benefits

The Governmental Accounting Standards Board recently released Statement Number 45, *Accounting and Reporting by Employers for Postemployment Benefits Other Than Pensions*. The new pronouncement provides guidance for local units of government in recognizing the cost of retiree health care, as well as any "other" postemployment benefits (other than pensions). The intent of the new rules is to recognize the cost of providing retiree health care coverage over the working life of the employee, rather than at the time the health care premiums are paid.

The new pronouncement will require the City to obtain a valuation of the obligation to provide retiree health care benefits, including an amortization of the past service cost over a period of up to 30 years. The valuation must include an annual recommended contribution (ARC). While the ARC does not need to be funded each year, any under funding must be reported as a liability on the government wide statement of net assets.

The GASB statement has provided substantial incentive to fund the obligation in accordance with the annual recommended contribution. In addition to the normal fairness issue of paying for a service as you use it, the GASB has directed that lower rates of return be used for evaluating the annual recommended contribution in situations where the recommended contribution is not being funded. This will significantly increase the calculation of the following year's contribution. As a result, funding the contribution on a current basis should reduce the long run cost. The accounting change will become effective for the year ended December 31, 2008.

Deposit and Investment Risk Disclosures

The Governmental Accounting Standards Board also issued statement Number 40, which will change the required disclosures related to the Retirement System's deposits and investments. The Statement addresses and requires additional disclosures for common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. The Statement also requires that the deposit and investment policies related to the risks noted above be disclosed.

The purpose of this Statement is to provide users of the financial statements information about deposit and investment risks that could affect the System's ability to meet its obligations as they become due. The new required disclosures should provide users of the financial statements with information necessary to assess the risks in deposit and investment transactions. The Statement will be effective for the Systems' December 31, 2005. It is our understanding that the System's current trustee, Mellon Trust, will be providing the information necessary to complete the new required disclosures for any assets for which they serve as custodian.

CAPROC Investments

In the past, there has been some confusion over the level of service Plante & Moran has provided to CAPROC. Plante & Moran is not, and never has been, the auditor for CAPROC. Plante & Moran was limited to the preparation of CAPROC's tax returns based on information provided by CAPROC. Plante & Moran no longer provides the tax preparation or any other services to CAPROC.

Document Storage

As mentioned in the past, the Retirement Systems are responsible for keeping many important documents and records that often times cannot be recreated (i.e., board minutes, member files, financial records, etc.). Given the very limited space allocated to the Retirement System's offices, it is difficult to provide adequate storage. It is imperative that the Systems maintain storage space that is not only well-organized, but also secure and fire proof. We recommend that the Retirement Systems review its current operating space and document storage facilities in an effort to improve conditions in order to ensure the safety of the related records.

In the past we have suggested looking into document imaging. Document imaging would mitigate the need to retain paper files for extended periods. Documents would instead be scanned to create an electronic backup. Document imaging, while not necessarily a new technology, is being used increasingly as a means to provide a safe and effective back up solution while maximizing space limitations.

We also continue to suggest that the Systems should consider various aspects of disaster recovery. If there were a fire or other catastrophe and the paper records and/or computer system were destroyed, the Systems should have a disaster recovery plan in place. Plante & Moran's Technology Consulting Solutions Team would be happy to speak with you about opportunities related to document imaging and disaster recovery.

We would like to thank the Retirement System's staff for the excellent cooperation extended to us during the audit. We look forward to discussing our comments and recommendations with

you. If you have any questions or require assistance in the implementation of our recommendations, please call at your convenience.

Very truly yours,

PLANTE & MORAN, PLLC



Beth A. Bialy



Wendy N. Trumbull